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In the Supreme Court of the United States

LABORATORY CORPORATION OF AMERICA HOLDINGS (D/B/A LABCORP),

Petitioner,

v.

METABOLITE LABORATORIES, INC., AND COMPETITIVE TECHNOLOGIES, INC.,

Respondents.

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On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF OF FINANCIAL SERVICES INDUSTRY *AMICI CURIAE* IN SUPPORT OF REVERSAL

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STATEMENT OF INTEREST OF *AMICI CURIAE*

Bear, Stearns & Co. Inc. and Lehman Brothers Inc. (collectively "Financial Services *Amici*") are among the leading participants in the financial services industry. The Financial Services *Amici* are participating in this case out of a deep concern about the threat to innovation—and thus to consumer welfare—posed by patents that claim exclusive rights to abstract ideas.[1]

As the facts of this case demonstrate, abstract ideas, whether in the form of known observations about natural phenomena or otherwise, now may be patented under current Federal Circuit precedent and, consequently, Patent and Trademark Office ("PTO") practice. The breadth and abstraction of the correlation step in the patent under review finds parallels in the many abstract ideas or insights about doing business that have received patent protection.

The Court's decision on the issues in this case relating to the proper scope of patentable subject matter could have significant economic repercussions. In particular, if in deciding this case the Court were to countenance patents that claim abstract ideas, the free-for-all in the patenting of abstract business methods would continue and undoubtedly hinder innovation and efficiency in the financial services industry for decades. In the last several years, business method patents already have purported to claim monopoly control over investment strategies. Yet, before the Federal Circuit's decision in *State Street Bank & Trust Co.* v. *Signature Financial Corp.*, 149 F.3d 1368, 1373 (1998), financial instruments and

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[1] Pursuant to Rule 37.3, the parties have consented to the filing of this brief and their consent letters have been lodged with the Clerk of the Court. Pursuant to Rule 37.6, the Financial Services *Amici* state that no counsel for a party has written this brief in whole or in part and that no party or entity, other than the Financial Services *Amici*, their members or their counsel has made a monetary contribution to the preparation or submission of this brief.

investment practices evolved and flourished within a competitive atmosphere that has made America's financial services industry the undisputed world leader without the need for government-granted monopolies over methods of doing business. Consumers reap the benefits of this strong and unimpeded competition, and should not be deprived of those benefits through an unwise extension of the scope of patentable subject matter beyond the boundaries contemplated by the terms of the Patent Code and by the constitutional provision authorizing the issuance of patents.

In approving and encouraging broad claims whose only point of novelty is a natural phenomenon or abstract idea, the Federal Circuit has departed from limits on patentable subject matter that this Court has consistently recognized in its decisions, most recently in *Diamond* v. *Diehr*, 450 U.S. 175 (1981). In addition, as this case illustrates, patents that assert claims to natural phenomena or abstract ideas almost necessarily raise issues of indefiniteness and inadequate description as well, impeding the notice function of the patent system to the detriment of innovation and consumer welfare.

This Court can and should reduce the risk to innovation and efficiency in the financial services industry by reaffirming that the patentability principles enunciated in *Diehr* and earlier cases. Those principles, by requiring that a patentable process produce an alteration in matter, exclude from the scope of patentable subject matter the mere invocation of abstract ideas, including known relationships among natural (or marketplace) phenomena. The Court has been equally clear that an abstraction does not become patentable merely by adding a token activity—"implementing" an idea in a business, or processing a formula on a computer. Abstractions may be ***included*** in a patentable claim if they are part of a novel process that produces a tangible result in the physical world, but mere insights or commercial principles should not be patentable in themselves.

ARGUMENT

The central issue in this case is whether a patent may monopolize the mental process of arriving at a conclusion based on pre-existing medical and chemical knowledge. That question has great import in the financial services industry because patents on abstract business methods similarly purport to claim general commercial principles and their application through thought or interpersonal management, without any tangible alteration to the physical world.

I. The Indefiniteness And Inadequate Description In This Case Are Symptoms Of An Artful Attempt To Claim Unpatentable Subject Matter.

The patent claim before this Court claims a "method" consisting of two steps: (1) "assaying a body fluid for an elevated level of total homocysteine"; and (2) "correlating an elevated level of total homocysteine in said body fluid with a deficiency of cobalmin or folate." Pet. App. 3a. As the petitioner has explained, these two claimed steps are indefinite and inadequately described because they merely identify general types of effort without explaining exactly what a person must do to perform the assay or correlation, in effect relying on additional *un*claimed steps.

The claim at issue appears to have been carefully drafted to capture a patent monopoly over physicians' pre-existing knowledge of chemical reactions involving homocysteine, folate, and cobalmin in the body, that is, known natural laws and phenomena. See Ruma V. Banerjee and Rowena G. Matthews, *Cobalamin-Dependent Methionine Synthase*, 4 FASEB JOURNAL 1450, 1450 (1990). Yet the patent could not claim that knowledge explicitly: a patent "claim covers and secures a process, a machine, a manufacture, a composition of matter, or a design, but never the function or result of either, nor the scientific explanation of their operation." *Markman* v. *Westview Instruments, Inc.*, 517 U.S. 370, 373 (1996).

The Federal Circuit nonetheless openly acknowledged that the "centerpiece of the invention" at issue here was the vaguely described mental process of assessing natural phenomena. Pet. App. 18a. By approving the use of the indefinite word "correlate," the Federal Circuit expanded the patent monopoly to include unpatentable abstract ideas. As this Court warned in *Markman*, however, indefinite language must not be used to expand the patent monopoly because "[t]he limits of a patent must be known for the protection of the patentee, the encouragement of the inventive genius of others and the assurance that the subject of the patent will be dedicated ultimately to the public." 517 U.S. at 390.

Although this Court has not explicitly addressed the interaction between indefiniteness and the limits on patentable subject matter, it has rejected efforts to circumvent those limits through artful drafting that merely places an abstract idea in a particular technical context:

> A mathematical formula as such is not accorded the protection of our patent laws, and this principle cannot be circumvented by attempting to limit the use of the formula to a particular technological environment. Similarly, insignificant post-solution activity will not transform an unpatentable principle into a patentable process. To hold otherwise would allow a competent draftsman to evade the recognized limitations on the type of subject matter eligible for patent protection.

Diamond v. *Diehr*, 450 U.S. 175, 191-92 (1981). The correlation step in the patent at issue in this case reflects exactly the kind of window-dressing atop an abstract idea that this Court strongly disapproved in *Diehr*. And it recalls many patents on abstract business methods that assert claims to insights about market, customer, or employee behavior.

In explicating the limits on patentable subject matter, and in disapproving the use of drafting to avoid them, this Court has preserved the "delicate balance" between the rights of the

public and inventors. *Festo Corp.* v. *Shoketsu Kinzoku Kogyo Kabushiki Co.*, 535 U.S. 722, 730-31 (2002). That balance requires clarity both as to what ***is*** claimed in a particular patent (*ibid.*) and to what ***may*** be claimed in the first place. By upholding the abstract patent claim here, the Federal Circuit allowed artful drafting to upset that balance.

II. This Court Should Address And Resolve The Underlying Problem Posed By The Federal Circuit's Refusal To Maintain Strict Limits On The Use Of Patents To Claim Monopolies Over Abstract Ideas.

Although it is not apparent from the result below, the law imposes limits on the types of activities and endeavors that may be patented. The Patent Code permits a patent to issue only on a "new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof." 35 U.S.C. § 101. This Court has held that certain subject matter does not fall within the recited scope. In particular, the Court has concluded that "laws of nature, natural phenomena, and abstract ideas" cannot be patented. *Diehr*, 450 U.S. at 185; see also *Diamond* v. *Chakrabarty*, 447 U.S. 303, 309 (1980) (referring to "physical phenomena"). Grouping laws of nature and natural phenomena together with abstract ideas is logical because, as expressed in a patent, a law of nature (like the chemical relationship at issue here) that has been reduced to human understanding is a type of abstract idea: namely, an abstraction from the physical world that identifies a pre-existing relationship or operation of matter in nature. See, *e.g.*, *Funk Brothers Seed Co.* v. *Kalo Inoculant Co.*, 333 U.S. 127, 131 (1948) (rejecting patent that purported to claim operation of certain bacteria on plants).

As a consequence, the relation between indefiniteness, inadequate description, and unpatentable subject matter outlined above is not limited to patents involving natural laws, but extends to all patents involving abstract ideas in the commercial as well as in the scientific context. Artful at-

tempts to patent abstract ideas may result in indefinite claims and inadequate descriptions, as shown above, but those are only symptoms of a more fundamental problem: the acquiescence of the Federal Circuit and the PTO in the patenting of abstract ideas. This problem is growing because the Federal Circuit has strayed from this Court's limits on patentable subject matter.

This Court has expressed those limits clearly enough when explaining what processes are patentable. In *Diehr*, the Court limited patent protection to processes that transform or reduce a physical article to another physical state or thing. 405 U.S. at 192. The Court drew on its precedents holding that a patentable "process requires that certain things should be done with certain ***substances***." *Id.* at 183-84 (quoting *Cochrane* v. *Deener*, 94 U.S. 780, 788 (1877)).

The Court also has addressed and rejected efforts to make an abstract idea patentable by such expedients as "limiting the use of [a] formula to a particular technological environment" or to "a particular technological use," *Diehr*, 450 U.S. at 191, 192 n.14, or by reciting some trivial and non-novel physical activity to take place after an abstract idea has been expressed. In the context of a patent that claimed the process of solving a mathematical formula, the Court pointedly held that "insignificant post-solution activity will not transform an unpatentable principle into a patentable process." *Id.* at 191-92. In so holding, the Court balanced the public's interest in free access to already-present "laws of nature, natural phenomena, and abstract ideas," against Congress' intent to extend patent protection to "anything under the sun that is made by man." Compare *id.* at 185, with *id.* at 182.

The Federal Circuit formerly paid lip-service to *Diehr*, holding that processes involving abstract ideas could not be patented unless their application produced a "useful, concrete, and tangible result." *In re Alappat*, 33 F.3d 1526, 1544 (Fed. Cir. 1994) (en banc). In more recent decisions, how-

ever—including the one under review—the Federal Circuit has dropped the requirements of concreteness and tangibility. Instead, that court allows trivial activity to render an abstract price calculation patentable. Thus, in its seminal *State Street* decision, the court forthrightly held that the mere "transformation of data, representing discrete dollar amounts, by a machine through a series of mathematical algorithim, formula, or calculation into a final share price" could receive a patent. 149 F.3d at 1373. The "tangible result" was "a final share price momentarily fixed for recording and reporting purposes." *Ibid.* That is, an abstract idea became patentable once it was expressed in a computer memory.

Although the patent in *State Street* claimed a machine that performed the recited process (through a means-plus-function claim, see 35 U.S.C. § 112 ¶ 6), the process, not the generically claimed "means," provided the point of novelty. The mere expedient of claiming the (unexceptional) computer that processes an abstract formula does not render the patent less abstract, or more compliant with 35 U.S.C. § 101. As Justice Story observed long ago, if a machine is "old and well known, and applied only to a new purpose, that does not make it patentable." *LeRoy* v. *Tatham*, 14 How. (55 U.S.) 156, 177 (1853) (quoting *Bean* v. *Smallwood*, 2 Story Rep. 408, 2 F. Cas 1142, 1143 (C.C.D. Mass. 1843) (Story, J.)).

Computers provide particularly ill-suited means to transform an unpatentable idea into a patentable process. To begin with, the functions that computers perform are qualitatively no different than mental processes. If those processes are not patentable when conducted in the mind or with paper and pencil, then they should not be patentable when conducted through software. As this Court recognized, if the use of an algorithm on a computer could be patentable, then that "in practical effect would be a patent on the algorithm itself." *Gottschalk* v. *Benson*, 409 U.S. 63, 72 (1972). Moreover, a computer exception would swallow the rule, as almost all abstract ideas—especially mathematical algorithms and for-

mulas implicated in abstract business method patents—may be implemented as software on a computer. Finally, although computer implementation may involve physical objects such as electrons, the transformations of matter that occur are not material to an invention that relies on the abstract content of a program or formula, as this Court implicitly recognized in *Benson* and *Parker* v. *Flook*, 437 U.S. 584, 590 (1978). "The end product" of a computer run is not anything so tangible as the "precisely cured rubber as it was in *Diehr* but rather different data as a mathematical function of the original data." *In re Alappat*, 33 F.3d 1526, 1564-1565 (Fed. Cir. 1994) (en banc) (Archer, J., dissenting).

Perhaps the most fundamentally troubling aspect of the *State Street* analysis is this: Any application of a mathematical algorithm that produces a price or other value used in a market transaction might be a patentable process under § 101 (though, of course, it would have to satisfy the novelty and other criteria for patentability as well). But that analysis conflicts with *Diehr*. The patented process does not "transform[] or reduc[e] an article to a different state or thing." *Diehr*, 450 U.S. at 192. Moreover, the use of a mathematical formula's output to set a price—like the processing of a formula on a computer—is exactly the type of "token post-solution activity" (*id.* at 192 n.14) that cannot "transform an unpatentable principle into a patentable process" (*id.* at 191-92).

The Federal Circuit extended its endorsement of the patenting of abstract ideas when it approved a patent on the use of simple Boolean algebra—a universally known mathematical algorithm—to generate numbers useful in identifying a telephone customer's long-distance carrier. The court of appeals held that this claimed use of a formula raised no meaningful questions of patentability "[b]ecause the claimed process applies the Boolean principle" for a particular technical purpose "without pre-empting other uses of the mathe-

matical principle." *AT&T Corp.* v. *Excel Communications, Inc.*, 172 F.3d 1352, 1358 (Fed. Cir. 1999).

That holding conflicts with this Court's conclusion that "[a] mathematical formula does not suddenly become patentable subject matter simply by having the applicant acquiesce to limiting the reach of the patent for the formula to a particular technological use." *Diehr*, 450 U.S. at 192 n.14. Yet the Federal Circuit characterized this Court's repeated pronouncements in *Diehr* linking patentable processes with physical effects as providing mere examples rather than a limiting principle. 172 F.3d at 1358-59. But see *Diehr*, 450 U.S. at 182 n.7 (quoting *Corning* v. *Burden*, 56 U.S. (15 How.) 252, 268 (1853), to the effect that patentable processes involve a "result or effect [that] is produced by chemical action, by the operation or application of some element or power of nature, or of one substance to another"); *Diehr*, 450 U.S. at 183 (quoting *Cochrane*, 94 U.S. at 788 (patentable process is a "mode of ***treatment of certain materials*** to produce a given result" (emphasis added)).

In two short steps, the Federal Circuit effectively nullified this Court's reservation of abstract ideas to the public domain—and attracted significant academic criticism in the process.[2] Now claims that would be utterly unpatentable under a common-sense reading of *Diehr* fall "comfortably * * * within the scope of [35 U.S.C.] § 101" as interpreted by the Federal Circuit. *Excel Communications*, 172 F.3d at 1358. As this Court warned long ago, without principled policing of the boundaries of patentable subject-matter, "every shadow

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[2] See, *e.g.*, Robert P. Merges, *As Many as Six Impossible Patents Before Breakfast: Property Rights for Business Concepts and Patent System Reform*, 14 BERKELEY TECH. L.J. 577 (1999); Leo J. Raskind, *The State Street Decision: The Bad Business of Unlimited Patent Protection for Methods of Doing Business*, 10 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 61, 61 (1999) (describing *State Street* as a "sweeping * * * departure from precedent").

of a shade of an idea" may be patentable. *Atlantic Works* v. *Brady*, 107 U.S. 192, 200 (1881). That is precisely the course that the Federal Circuit has chosen with its nearly standardless approach, at high cost to the financial service industry's competitive environment.

III. The Federal Circuit's Expansion Of Patentable Subject Matter Has Encouraged The PTO To Issue Patents On Abstract Business Methods.

Under the Federal Circuit's recent decisions, patentees now may seize monopolies on particular ways of doing business by claiming protection for the abstract ideas that underlie the creation of an investment product or a management scheme. Unsurprisingly, annual applications for patents on business methods have risen from the low hundreds in 1995 to more than 6000 today.[3]

The explosion in business method patent applications is easy to explain: The Federal Circuit's departure from this Court's guidance made virtually any use of a natural phenomenon, mathematical algorithm, or other abstract idea potentially patentable. Business processes fit this bill; the use of computers and, in many cases, the Internet to do business provided a fig-leaf sufficient to make old practices seem new and superficially technological. Moreover, many remunerative business activities—especially in the financial services industry—consist of processing mathematical algorithms on computers in conjunction with Internet-based communication. As a consequence, applications have poured in.

In response to the Federal Circuit's decisions, the PTO has instructed its patent examiners to take an extremely broad view of patentability. An example provided in a 2001 PTO examiner training course emphasized how insignificant post-

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[3] See U.S. Patent and Trademark Office, Class 705 Application Filing and Patents Issued Data, *available at* http://www.uspto.gov/web/menu/pbmethod/applicationfiling.htm.

solution activity could be and still satisfy *State Street* and *Excel Communications*. The trainers imagined the following patent claim:

> Claim 1. A method comprising the steps of:
>
> (a) convening people in a room; and
>
> (b) brainstorming to generate a series of steps forming a scheme for reducing the number of patent applications pending in the Technology Center.

U.S. PTO, 35 U.S.C. § 101 Training Materials, Slide 23 (ca. Aug. 5, 2001), *available at* http://web.archive.org/web/20010805115843 (search term: http://www.uspto.gov/web/menu/pbmethod/trangmaterials.ppt). This claim was unpatentable beause it "merely manipulated an abstract idea without producing a useful, concrete and tangible result." *Id.* at Slide 24. But according to the PTO Trainers, adding the following dependent claim allowed the earlier claim to meet the Federal Circuit's test:

> The method of Claim 1, further comprising the step of * * * ***implementing the steps of the scheme***.

Id. at Slide 26 (emphasis added). This is exactly the sort of insignificant (and indefinite) addition to a claim for an abstract idea that this Court held insufficient in *Diehr*, 450 U.S. at 191-92.

The Board of Patent Appeals and Interferences confirmed this exceptionally broad view of patentability in a recent precedential decision, *Ex parte Lundgren*, Appeal No. 2033-2088, Application 08/093,516, 2004 WL 3561262 (heard Apr. 20, 2004). Lundgren claimed a method for setting compensation for managers using competitive benchmarks.[4] That method consisted merely of applying a mathematical algo-

[4] Lundgren already owns a patent for a "Method of eliciting unbiased forecasts by relating a forecaster's pay to the forecaster's contribution to a collective forecast." Patent No. 5,608,620.

rithm designed to prevent collusion among managers in a given comparison group and adding this token step:

> transferring compensation to said manager, said transferred compensation having a value related to said managerial compensation amount [determined by applying the mathematical algorithm].

2004 WL 3561262, at *1.

The examiner rejected the application as an unpatentable effort to claim "an economic theory expressed as a mathematical algorithm" (*id.* at *2), but the Board reversed, chiding the examiner in these terms:

> Since the Federal Circuit has held that a process claim that applies a mathematical algorithm to "produce a useful, concrete, tangible result without pre-empting other uses of the mathematical principle, on its face comfortably falls within the scope of § 101," one would think there would be no more issues to be resolved under [35 U.S.C.] § 101.

Id. at *3 (quoting *Excel Communications*, 172 F.3d at 1358).

In particular, the Board rejected that notion a patent needed to involve any "technological arts" that would distinguish the claims from an effort to patent mental processes. *Id.* at *3. The Board did not acknowledge this Court's concrete, tangible formulation of the scope of patentable processes in *Diehr*. Rather, the Board concluded, because this Court made "no reference * * * to the [PTO's then-]new technological-arts standard" in *Benson*, the Court had rejected the notion that a patentable process had to involve the manipulation of matter in some way. See *Lundgren*, 2004 WL 3561262, at *4-*5 (quoting *Diehr*, 450 U.S. at 201 (Stevens, J., dissenting)).

Yet although the Board quoted further from Justice Stevens' summary of *Benson* in his dissenting opinion in *Diehr*,

those words went unheeded. In the relevant passage, Justice Stevens explained that

> the Court clearly held [in *Benson*] that new mathematical procedures that can be conducted in old computers, like mental processes and abstract intellectual concepts, see [409 U.S. at 67], are not patentable processes within the meaning of [35 U.S.C.] § 101.

That summary closely describes the patent in *State Street*. And the step of "implementing" an abstract incentive scheme in a business bears the same characteristics: an effort to use vaguely described, routine activity to secure a patent on an assertedly novel but wholly abstract idea. This Court has held that merely "implement[ing] a principle in some specific fashion" does not render a process patentable. *Flook*, 437 U.S. at 593. Simply using the word "implementing" can accomplish no more.

If the drafter of a patent may bring a mathematical algorithm "comfortably * * * within" the scope of patent protection simply by adding a token indication of use—"implementing the steps of the scheme" or "transferring compensation to said manager"—any mathematical algorithm can be patented. *Lundgren* firmly establishes the PTO's intention to continue issuing highly abstract business method patents.

It is no answer to say that any subject-matter errors by the PTO may be corrected in litigation challenging the validity of over-reaching patents. Not only is patent litigation notoriously expensive, see American Intellectual Property Law Association, *2005 Report of the Economic Survey* I-110, Table Q42f (reporting $5 million median cost for patent infringement suit with $25 million or more at stake), but a challenger to a patent's validity bears a heavy burden: "[A]ll patents are presumed valid." *Cardinal Chemical Co.* v. *Morton International, Inc.*, 508 U.S. 83, 93 n.15 (1993) (citing 35 U.S.C. § 282). Indeed, the Federal Circuit's appe-

tite for the patenting of abstract ideas makes that presumption nearly impossible to overcome where the flaw is ineligible subject matter.

IV. Abstract Business Method Patents Slow Innovation In The Financial Services Industry, Disrupt Its Participants, And Harm Consumers.

By allowing patentees to claim abstract ideas, the Federal Circuit and PTO are narrowing the public domain in areas of significant—and rapid—innovation. An overbroad patenting regime threatens innovation not only in the biological and medical sciences (as the present case demonstrates), but also in the financial services industry, another area vital to the Nation's economy.

A. Abstract Business Method Patents Hinder Innovation In The Financial Services Industry

Before *State Street*, innovation in the securities industry flourished without patent protection, generating between 1200 and 1800 new types of trade securities from 1980 to 2001. See, *e.g.*, Robert P. Merges, *The Uninvited Guest: Patents on Wall Street*, UC BERKELEY PUBLIC LAW RESEARCH PAPER NO. 126 at 7 (May 2003); see also W. Landes & R. Posner, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 329 (2003) ("Despite the unavailability of business method patents until quite recently, there has been no shortage of marketing innovations."). Indeed, from the 1970s onward, this industry has brought forth a myriad of new products for investors. These advances include exchange-traded futures and options contracts on financial instruments (including equity options and Treasury futures); over-the-counter products linked to a variety of asset classes or indices (*e.g.*, equity derivatives, credit derivatives, currency and interest rate derivatives and inflation-linked products); and innovative forms of securities investments, including index-

linked securities, mortgage-backed securities, and securities backed by other assets.

Much of that innovation consists of imitation of, and incremental improvement on, new methods of investment and finance. Both the nature of business methods generally, and the transparency of American financial markets in particular, make it unlikely that effective methods will be long concealed: "Businesses are largely practiced in public." Rochelle Cooper Dreyfuss, *Are Business Method Patents Bad for Business?*, 16 SANTA CLARA COMPUTER & HIGH TECH. L.J. 263, 274 (2000).

> Accordingly, there is little need to especially encourage disclosure. Business methods are also hard to free ride on. They depend in strong ways on the social structure within the firms utilizing them—on compensation schemes, lines of reporting, supervising policies, and other business factors. * * * With lock in, network effects, and even good old fashioned loyalty, lead time (the first mover advantage) goes a long way to assuring returns adequate to recoup costs and earn substantial profit.

Id. at 274-75.

Because American financial markets are highly efficient, information travels quickly within them—and within the financial services industry. Product cycles are short—far shorter than the 20-year patent term—because innovation also spreads quickly. Indeed, competitors often adapt their own versions of new product ideas within weeks after the products' initial introduction into the market. Bankers and brokers constantly develop and refine investment products that their competitors duplicate, while adding variations to their offerings in efforts to improve their products and services. In short, methods of doing business develop through competition as the market ruthlessly wrings out inefficiency.

Not only do abstract business method patents provide few if any discernible benefits in financial services markets, but those patents have marked deleterious effects. The financial services industry is a natural target for abstract business method patents, as the setting of the *State Street* case underscores. The very stock-in-trade of the industry is the harnessing of mathematical concepts toward the development of new financial products, transaction strategies, and marketplaces. Business methods fundamentally differ "from the subject matter of most patent protection because 'they affect not just products in competition, but rather the competitive process itself.' "[5] In addition, high transaction volumes in the financial services industry mean that a small slice of each transaction can produce huge royalties—and enormous deadweight losses to consumers.

Further, the availability of abstract business method patents diverts business investment away from true innovation that benefits consumers to defensive actions that primarily benefit patent lawyers. Existing financial services firms are forced to accumulate portfolios of "defensive" business method patents so that they have bargaining chips available for future negotiations and litigation with competitors and other business method patent holders who have no business but the exploitation of patents on the businesses of others.

This Court long ago addressed the latter problem, albeit in a different technological context. The Court's words aptly describe the results of allowing abstract business method pat-

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[5] Brian P. Biddinger, Note, *Limiting the Business Method Patent: A Comparison and Proposed Alignment of European, Japanese and United States Patent Law*, 69 FORDHAM L. REV. 2523, 2545 (2001) (quoting an unpublished early version of Rochelle Cooper Dreyfuss, *State Street or Easy Street: Is Patenting Business Methods Good for Business?*, in U.S. INTELLECTUAL PROPERTY: LAW AND POLICY (Hugh Hansen ed., 2001)).

ents. That practice, especially as pursued by non-participants in the relevant industry,

> creates a class of speculative schemers who make it their business to watch the advancing wave of improvement, and gather its foam in the form of patented monopolies, which enable them to lay a heavy tax upon the industry of the country, without contributing anything to the real advancement of the arts. It embarrasses the honest pursuit of business with fears and apprehensions of concealed liens and unknown liabilities to lawsuits and vexatious accountings for profits made in good faith.

Atlantic Works, 107 U.S. at 200.

Finally, abstract business method patents restrict innovation by introducing market inefficiencies that competition cannot correct. A broad patent can lengthen product cycles, as the expenses of litigation or royalties deters firms from devoting resources to fields potentially covered by business method patents. And such a patent may allow a single firm to exclude all competitors from a field of investment (or to collect rents from those who want to compete).

The historical development of the financial services industry reflected the historic view of the federal courts that "an art" (or, in current statutory terminology, a "process," see *Diehr*, 450 U.S. at 182-183) "is not a mere abstraction." *Hotel Security Checking Co.* v. *Lorraine Co.*, 160 F. 467, 469 (2d Cir. 1908). As a consequence, "[a] system of transacting business disconnected from the means for carrying out the system is not, within the most liberal interpretation of the term, an art." *Ibid.* By resuscitating the contrary notion ninety years later, the Federal Circuit has upset settled industry expectations.

B. Abstract Business Method Patents Are Currently Disrupting The Financial Industry And Its Consumers.

Because *State Street* was decided only seven years ago, the full impact of the Federal Circuit's unprecedented expansion of the scope of patentable subject matter is unclear. Even so, some firms already have used abstract business method patents to try to monopolize—or collect monopoly rents on—vital national markets.

1. eSpeed Inc. brought patent infringement lawsuits against several securities trading firms for infringing a patent for an "Automated auction protocol processor." The asserted claims covered a method of managing auction trades. See, *e.g.*, *eSpeed, Inc.* v. *Brokertek USA, LLC*, Case No. 03-612 (D. Del. Dec. 5, 2005) (mem. order). Although Brokertek and the other defendants prevailed at trial on the ground that the patent was invalid for insufficient written description (*id.* at 3), the defense against the invalid patent lasted two and one-half years and cost millions of dollars. And that defense is not over yet. The appellate process has just begun and—if the present case is any indication—the Federal Circuit may impose a more forgiving view of the written description requirement.

In earlier litigation, eSpeed enforced a patent for an "Automated Futures Trading Exchange" against the Chicago Mercantile Exchange, the Chicago Board of Trade, and NYMEX. eSpeed originally was a defendant in the matter, but settled with the original plaintiff by "purchas[ing] the patent along with the right to act as plaintiff in the present litigation." *eSpeed, Inc.* v. *Bd. of Trade*, Case No. M8-85(SCH), 2002 WL 827099, at *2 (S.D.N.Y. May 1, 2002). eSpeed then extracted a reported $48 million in license fees by settling with the other defendants and reaching agreement with IntercontinentalExchange without filing suit. See Mary Schroeder, *CME, CBOT to Pay eSpeed $30M in Patent Dis-*

pute, Sec. Indus. News, Sept. 2, 2002; Press Release, eSpeed, Inc., *eSpeed and New York Mercantile Exchange Reach Settlement Agreement on Wagner Patent* (Dec. 22, 2003), *available at* http://www.espeed.com/articles/article20031222.htm. The net result imposed increased costs (and deadweight losses) on every trade on a major U.S. futures exchange.

2. Priceline.com holds patents claiming a method for administering a "Dutch auction" over the Internet. See U.S. Patent No. 5,794,207, col. 32, ll. 40-54 (Claim 1); see also Patent No. 5,797,127 ("Method, apparatus, and program for pricing, selling, and exercising options to purchase airline tickets"). But a Dutch Auction is a "business method" that the U.S. Treasury uses to sell hundreds of billions of dollars' worth of securities each year. As Judge Posner observed, "the new 'business method' patents create the potential for inventors of new methods of doing business to obtain enormous monopoly power (imagine if the first person to think up the auction had been able to patent it); such patents also create a reward greatly in excess of the cost of the invention." Richard A. Posner, *The Law & Economics of Intellectual Property*, Daedalus, Spring 2002, at 5.

3. The PTO has even issued patents on basic financial instruments. Patent No. 6,963,852, for a "System and method for creating a defined benefit pension plan funded with a variable life insurance policy and/or a variable annuity policy," is a glaring example. That patent claims, among other things (*id.* col. 17, ll. 54-67):

> A computer-implemented data-processing method for creating a qualified defined benefit pension plan funded using variable life insurance contracts, the method comprising:
>
> (a) entering, via at least one user interface, actuarial data used to create the qualified defined benefit pension plan;

(b) based on the actuarial data, electronically generating a variable life insurance policy;

(c) funding the qualified defined benefit pension plan using the variable life insurance policy;

(d) electronically generating a separate agreement that extra-contractually modifies the variable life insurance policy, wherein the plan includes the policy and the separate agreement; and

(e) providing a guaranty of the plan benefits using the plan's policy and separate agreement.

Because defined-benefits pension plans funded by variable life insurance policies or variable annuities have existed for years, the patent holder had many potential targets for patent infringement suits. He has sued both Nationwide Life Insurance Co. and Travelers Life & Annuity Co.; the insurers responded by seeking declaratory judgments of non-infringement and invalidity. See *Travelers Life & Annuity Co.* v. *Koresko*, No. 05-5862 (E.D. Pa. filed Nov. 8, 2005); *Nationwide Life Insurance Co.* v. *Koresko*, No. 05-2006 (S.D. Ohio filed Nov. 23, 2005). The insurers may well succeed but have been forced to litigate their right to use an established, well-known financial instrument.

4. Another patent, although not yet the subject of reported litigation, illustrates how the most established and fundamental investment ideas and practices may receive patent protection. Entitled "Method and system for enabling smaller investors to manage risk in a self-managed portfolio of assets/liabilities," the patent claims (among other things):

A computer-based method for enabling an individual investor to manage risk underlying an investment comprising the steps of:

a) creating a representative portfolio of assets/liabilities that have a correlation to the in-

vestment for which the individual investor desires to manage risk;

b) submitting the representative portfolio to a computer system over a communications link; and

c) analyzing the representative portfolio using a processor to determine a price to charge the user to insure the value of the representative portfolio at a predetermined level at a predetermined time.

U.S. Patent No. 6,360,210, col. 16, l. 65-col. 17, l. 9 (Claim 27). That claim amounts to the mental activities involved in the creation and analysis of an investment portfolio. That something so routine could be patented highlights a particular problem in the patenting process if abstract ideas can be patented. For a business process like this, the prior art that might establish that the invention was not novel does not exist in patents or scientific papers. Rather, the mental processes claimed here and in other business method patents derive from common practice in the business world or directly from common sense—two sources that are difficult if not impossible to identify, assess, and compare to a patent application. For that reason, abstract business methods, like mathematical formulae, should be treated as part of the prior art as a matter of law. See *Flook*, 437 U.S. at 594.

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Before the Federal Circuit improperly expanded the scope of patent protection to include natural phenomena and abstract ideas, American financial markets thoroughly enabled efficient investment in innovation. This Court should restore the "delicate balance" (*Festo*, 535 U.S. at 730-31) that the Federal Circuit has upset. The need for reaffirmed guidance is especially acute in innovative sectors such as financial services where existing incentives for innovation are robust. Inventors should not be allowed to seize abstract ideas from the public.

V. By Reaffirming Its Precedents Requiring Patentable Processes To Be Physical And Material, This Court Can Forestall The Patenting Of Abstract Business Methods And Other Abstract Ideas.

The Federal Circuit has misinterpreted this Court's observation that the statutory subject matter of patent protection extends to "anything under the sun that is made by man" (*Chakrabarty*, 447 U.S. at 309) to mean that any ***insight*** or ***conclusion*** "made" by individuals may be patentable, whether or not that insight is part of a process that "makes" anything in the common-sense, tangible meaning of the word. To forestall the patenting of abstract ideas, the Court should reaffirm what it said in *Diehr* and many earlier decisions: that patentable processes must be ***physical*** and ***material*** because a "process" within the meaning of 35 U.S.C. § 101 "is a mode of treatment of certain ***materials*** to produce a given result." *Diehr*, 450 U.S. at 183 (emphasis added).

A. Requiring Patented Processes To Be Physical And Material Will Exclude Abstract Business Methods And Other Abstract Ideas.

This Court already has articulated the elements of an appropriate two-part analysis that would (1) exclude abstract ideas from the scope of patentability in the first instance, and (2) ensure that the addition of a vague and insubstantial step to an unpatentable idea would not succeed in securing a patent. This Court could end much patenting mischief simply by reaffirming that it meant what it said and enforcing the Federal Circuit's duty to comply with higher authority. See, *e.g.*, *Festo*, 535 U.S. at 724.

The Court has adhered to these standards from its early days. See *Flook*, 437 U.S. at 588 n.9 (noting that "[a]n argument can be made * * * that this Court has only recognized a process as within the statutory definition" if these requirements were satisfied). It is true that the Court in *Benson* declined to " hold that no process patent could ever qualify if it

did not meet the requirements of our prior precedents," 409 U.S. at 71, and that in *Flook*, 437 U.S. at 588 n.9, the Court assumed that the requirements were not exclusive. But the Court applied the test without apology in *Diehr*, and now—in light of the Federal Circuit's aggressive expansion of the subject-matter scope of patentable processes—has reached the point at which forthright, unambiguous guidance is necessary.

The Court's only alternative is to acquiesce in the Federal Circuit's limitless view. But that course would contravene this Court's precedents as well. The Court has recognized its duty to "proceed cautiously when [it is] asked to expand patent rights into areas wholly unforeseen by Congress." *Flook*, 437 U.S. at 596. Lacking a "clear and certain signal from Congress," *ibid.* (quoting *Deepsouth Packing Co.* v. *Laitram Corp.*, 406 U.S. 518, 5531 (1972)), that might confirm that the scope of patentable subject matter should be expanded, this Court should adhere to the clear dividing line expressed in its precedents. The proliferation of abstract business method patents should prompt the Court to make indisputably clear that the line is where *Diehr* left it.

First, this Court should confirm its identification in *Diehr* of the "clue to the patentability" of any process, whether or not it incorporates algorithms or other abstract principles. 450 U.S. at 184. To be patentable, the Court explained, a process must either (1) "include" a "particular machine" or (2) result in the "transformation" of a tangible "article" to a different state. *Ibid.* By its plain terms that formulation excludes interpersonal, societal, and financial methods and relationships as opposed to technological developments. *Cf.* European Patent Convention Art. 52(2)(c) (rendering "schemes, rules and methods for performing mental acts, playing games or doing business" unpatentable per se).

Second, and just as important, the Court should preclude the use of indefinite claims to embrace unpatentable subject

matter, for example by including some token step in addition to the expression or consideration of an abstract idea. As the Court has instructed, "a mathematical formula does not become patentable subject matter merely by including in the claim for the formula token postsolution activity." *Diehr*, 450 U.S. at 192 n.14; see also *id.* at 191-92 ("insignificant postsolution activity will not transform an unpatentable principle into a patentable process"). This "token" activity includes such steps as carrying out the calculation of an abstract formula on a non-novel computer system or "implementing" an abstract business scheme within an enterprise.

The principles underlying business methods are "basic tools" of commerce just as algorithms are "basic tools of scientific and technological work," and like algorithms, they should be "treated as though [they] were a familiar part of the prior art." *Flook*, 437 U.S. at 591-592. Each type of principle "reveals a relationship that has always existed." *Id.* at 593 n.15. As a consequence, just as with a patent incorporating a mathematical algorithm, the question for a patent including a business method should be whether, when the principle or insight underlying the business method "is assumed to be within the prior art, the application, as a whole, contains" a "patentable invention." *Id.* at 594.

Reaffirming the clear standards expressed in *Diehr* will prevent the Federal Circuit from impermissibly expanding the scope of patent protection until it swallows all branches of human activity. "Anything under the sun which is made by man" should mean just that: ***made***, not simply thought of.

B. Conversely, Allowing Patents For Abstract Business Methods Would Raise Serious Constitutional Doubts.

Another reason to reaffirm the subject-matter limitations recognized in *Diehr* is this Court's established practice of construing statutes to avoid "grave and doubtful constitutional questions." *Jones* v. *United States*, 529 U.S. 848, 849

(2000). The Constitution permits Congress to give "Inventors the exclusive Right to their * * * Discoveries" only "[t]o promote the Progress of Science and useful Arts." U.S. Const. Art. I, § 8. As this Court has recognized, the Framers intended the patent power as a narrow exception to the general common-law prohibition against monopolies in business:

> [T]he federal patent power * * * unlike the power often exercised in the sixteenth and seventeenth centuries by the English Crown, is limited to the promotion of advances in the 'useful arts.' It was written against the backdrop of the practices—eventually curtailed by the Statute of Monopolies—of the Crown in granting monopolies to court favorites in goods or businesses which had long before been enjoyed by the public.[6]

Graham v. *John Deere Co.*, 383 U.S. 1, 5 (1966) (internal citation and footnote omitted); see also Robert P. Merges, *The Proper Scope of the Copyright and Patent Power*, 37 HARVARD J. ON LEGIS. 45, 47-48 (2000).

The notion that an abstract method of doing business is an art or science under the Constitution is unlikely as an historical matter. The Framers considered and rejected a broader patent power which would have allowed Congress to "to establish public institutions, rewards, and immunities for the promotion of agriculture, commerce, and manufactures." Joseph Story, 3 COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1150 (1833). Not content with the rejection of this proposal, several state ratifying conventions sought amendments prohibiting Congress from granting "exclusive advantages in ***commerce***" to anyone.[7] Allowing individuals

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[6] The Statute of Monopolies, 1623, Jam. 1, c. 3, outlawed all grants of monopoly *except* for patents covering "the sole Working or Making of any manner of new Manufactures." *Id.* § 6. See *United States* v. *Line Material Co.*, 333 U.S. 287, 330 n.10 (1948).

[7] *Ratification of the New Constitution by the Convention of the State of New York*, 4 AMERICAN MUSEUM 153, 156 (Philadelphia,

to obtain exclusive rights in the methods of commerce would have the same forbidden effect.

The Framers carved out the patent power as a special exception for monopolies to encourage innovation, but explicitly "limited" that power "to the promotion of advances in the 'useful arts.' " *Graham*, 383 U.S. at 5. They denied Congress the power to grant business monopolies. This Court should restore the balance that the Framers established and should construe the subject-matter limitations of the Patent Code to "avoid the constitutional question that would arise" (*Jones*, 529 U.S. at 858) if abstract methods of commerce were recognized as patentable processes.

* * *

Removing intellectual exercises, such as abstract business methods, from the scope of patentable subject matter benefits consumers by ensuring that strong competition in methods of analysis and means of providing services may continue without artificial restriction. The highly efficient and intensely innovative financial services markets in the United States should not be stifled by Federal Circuit decisions that depart from this Court's precedents and allow patentees to monopolize abstract methods and ideas.

Matthew Carey 1789) (emphasis added); *Remarks on the Amendments to the Federal Constitution Proposed by the Conventions of Massachusetts, New Hampshire, New York, Virginia, South and North Carolina, with the Minorities of Pennsylvania and Maryland by the Rev. Nicholas Collin, D.D.*, 6 AMERICAN MUSEUM 303, 303 (Philadelphia, Carey, Stewart & Co. 1789).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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